

Message Text

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FM AMEMBASSY PARIS
TO SECSTATE WASHDC 4151
INFO AMEMBASSY BERN
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USOECD

USEEC ALSO FOR EMBASSY

PASS TREASURY, FEDERAL RESERVE AND COMMERCE

E.O. 11652: N/A
TAGS: EFIN, EINV, ETRD, EWWT, UK, IR, OECD
SUBJECT: JUNE 26 - 28 MEETING OF INVISIBLES COMMITTEE

REF: A) PARIS 11897, B) TIR/A(78)3, C) TIR(78)4

1. SUMMARY: INVISIBLES COMMITTEE (IC) HAD LENGTHY AND
RELATIVELY FRUITFUL DISCUSSION OF UK RESERVATIONS TO
CAPITAL MOVEMENTS CODE (CMC); AGREED RECOMMENDATIONS ON
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UK INCLUDE CALLS FOR UNDERTAKING FUNDAMENTAL REVIEW OF
RESTRICTIVE SYSTEM OF EXCHANGE CONTROLS AND FOR ENDING
DISCRIMINATORY FEATURES BY EXTENDING LIBERALIZATION TO
ALL OECD COUNTRIES. RESULTS OF REVIEW OF IRISH
RESERVATIONS FOLLOWED LINES ESTABLISHED BY UK REVIEW,
WITH SOME ALLOWANCE BEING MADE FOR MORE VULNERABLE
IRISH ECONOMY. FILMS REVIEW NOT COMPLETED, BUT

SPANISH INDICATED READINESS TO SOFTEN DUBBING TAX ON IMPORTED FILMS. IC AGREED TO JAPANESE AND SWISS REQUESTS FOR DEROGATION TO COVER RECENTLY INSTITUTED CONTROLS ON CAPITAL INFLOWS. NOVEMBER 27 - 28 DATE SET FOR "SPECIAL SESSION" ON DIRECT INVESTMENT. IC WAS REMINDED THAT NEW SHIPPING PRINCIPLES BEING DISCUSSED IN MARITIME TRANSPORT COMMITTEE WILL REQUIRE LOOK AT THEIR COMPATIBILITY WITH NOTE 1 TO ANNEX A OF INVISIBLES CODE. END SUMMARY

2. IC MET JUNE 26 - 28, WITH SWISS VICE-CHAIRMAN PRESIDING. MAIN FEATURE OF SECRETARIAT'S REPORT ON RECENT DEVELOPMENTS WAS BRIEFING (BY HUMPHREY) OF REVIEW OF SHIPPING PRINCIPLES BEING UNDERTAKEN BY MARITIME TRANSPORT COMMITTEE (MTC) AND ITS WORKING PARTY. IC INFORMED THAT ITS ADVICE WOULD BE SOUGHT (AFTER MTC HAS CRYSTALIZED ITS VIEWS) CONCERNING: (A) COMPATIBILITY OF NEW PRINCIPLES WITH PROVISIONS OF CODE OF LIBERALIZATION OF CURRENT INVISIBLE OPERATIONS (I.E., NOTE 1 TO ANNEX A OF CODE); (B) IF FOUND INCOMPATIBLE, ALTERNATIVES OF REINTERPRETING NOTE 1 OR REVISING IT. MTC MIGHT BE READY TO TRANSMIT FORMAL REQUEST TO IC IN OCTOBER.

3. CONSIDERATION OF RECENT MEASURES TAKEN BY MEMBER COUNTRIES BASED ON WORKING DOCUMENT NO. 1, COPIES OF LIMITED OFFICIAL USE

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WHICH MAILED TO EUR/RPE(JONIETZ) AND TREASURY (ALTHEIM). MAIN FEATURES OF DISCUSSION WERE:

(A) SPANISH EXPERT REPORTED THAT SPAIN HAS ADOPTED NEW DIRECT INVESTMENT REGULATIONS, DETAILS OF WHICH WILL BE NOTIFIED.

(B) FRENCH ALTERNATE MEMBER SAID GOF HAS NOT YET GIVEN AUTHORIZATION FOR PURCHASE BY LUCAS FRANCE (SUBSIDIARY OF LUCAS UK) OF THE REMAINING 51 PERCENT OF DUCELLIER FROM DBA, A SUBSIDIARY OF U.S. BENDIX CORPORATION. NEGOTIATIONS SAID TO BE UNDERWAY, AND IT MAY BE A QUESTION OF BREAKING UP THE COMPANY. RESPONSE PROMISED TO U.S. MEMBER'S INQUIRY (RAISED IN APRIL -- SEE REF A) CONCERNING REPORTS THAT FOREIGNERS SELLING PROPERTY IN FRANCE ENCOUNTERED CONSIDERABLE DIFFICULTY IN TRANSFERRING PROCEEDS DUE TO TAX REGULATIONS.

(C) SWEDISH ALTERNATE CONFIRMED THAT GOS HAS INTRODUCED NEW RULES FOR EXPORT CREDIT AND REPORTED THAT THEY ENTAIL COMPENSATING EXPORTERS FOR DIFFERENCE BETWEEN COST OF BORROWING DOMESTICALLY AND THEIR CHARGES FOR

LENDING TO FOREIGN BUYERS. HE WILL PROVIDE DETAILS
LATER.

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(D) UK EXPERT PROMISED RESPONSE TO U.S. EXPERT'S
EARLIER INQUIRY (PARA 2, REF A) CONCERNING REPORTS OF
MORE LIBERAL ECGD PRACTICES TO FINANCE CERTAIN
EXPORTS TO OTHER EC COUNTRIES.

4. FILMS. SEPTTEL WILL REPORT EXAMINATION OF
RESERVATIONS (INVISIBLES CODE) RELATED TO FILMS.
REVIEW COULD NOT BE COMPLETED IN TIME ALLOTTED.
HOWEVER, SPANISH EXPERTS WERE FORTHCOMING IN INDICATING
INTENTION TO INTRODUCE LEGISLATION REVAMPING STATUTES
RELATED TO FILMS AND, IN INTERIM, POSSIBLY TO EASE
EXISTING TAX ON DUBBING OF IMPORTED FILMS.
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FOURTH EXAMINATION OF UK RESERVATIONS TO CMC
(DAF/INV/78'32)

5. IC SPENT FULL DAY ON UK RESERVATIONS, CONSIDERABLE PORTION OF WHICH DEVOTED TO GENERAL (BUT BASIC) QUESTIONS CONCERNING EFFICACY OF EXCHANGE CONTROLS. (DETAILED REPORT IS PROVIDED HERE IN VIEW OF IMPORTANCE OF UK AND COMPREHENSIVE NATURE OF CONTROLS.) HMG ABLY REPRESENTED BY COLIN WARD (ALTERNATE UK MEMBER) FROM TREASURY AND WILLETTS FROM BANK OF ENGLAND. WARD NOTED THAT UK SYSTEM GREW OUT OF WARTIME CONTROLS, BUT IS UNDER COMPLETE AUTHORITY OF EXECUTIVE AND THUS HIGHLY FLEXIBLE. BASIC OBJECTIVE IS NOT TO PREVENT CAPITAL OUTFLOWS, BUT TO LIMIT AND DEFER THEIR IMPACT ON BALANCE OF PAYMENTS (THROUGH PAYMENT CHANNELS REQUIREMENT). NON-RESIDENTS TRANSACTIONS ARE FREE. BASIC FOCUS IS ON RESIDENTS' TRANSACTIONS IN:

(A) OUTWARD DIRECT INVESTMENT. MAIN CONSIDERATION IS POLITICAL OPPOSITION, AS HMG ADMITS THAT ARGUMENTS CONCERNING "JOB EXPORTS" LACK ECONOMIC VALIDITY. WARD CONCEDED THAT THERE IS UNLIKELY TO BE PENT-UP DEMAND FOR DIRECT INVESTMENT ABROAD WHICH WOULD BE RELEASED IF PREMIUM OVER MARKET EXCHANGE RATE WERE ABOLISHED (I.E., DESIRED INVESTMENTS CAN BE READILY FINANCED WITH RETAINED EARNINGS AND/OR FOREIGN BORROWINGS). HOWEVER, EMPHASIZED THAT UK WOULD HAVE GREAT DIFFICULTY IN MAKING FURTHER MOVES AT PRESENT TIME IN LIGHT OF POLITICAL SITUATION.

(B) OUTWARD PORTFOLIO INVESTMENT. HERE THE POLITICAL CONCERN ABOUT A "DRAIN ON RESOURCES" THROUGH CAPITAL

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EXPORTS IS NOT WELL ARTICULATED AND RELATIVELY UNIMPORTANT. HM TREASURY IS, HOWEVER, EXTREMELY SENSITIVE TO THE SCOPE FOR OUTWARD MOVEMENTS IF THE INVESTMENT CURRENCY SYSTEM WERE ABOLISHED -- BOTH FROM STANDPOINT OF VOLUME (PERHAPS 3 BILLION POUNDS) AND VOLATILITY. CIVIL SERVANT LEVEL HAS CONSIDERED (WITHOUT POLITICAL LEVEL INSTRUCTION) WHETHER SYSTEM COULD BE ABOLISHED OR MODIFIED BUT HAS BEEN UNABLE TO DEVELOP A REALISTIC SCHEME. SIZE OF PREMIUM ON INVESTMENT CURRENCY IS A MAJOR FACTOR (VIZ., ADVERSE IMPACT

OF ABOLITION ON INVESTORS' BALANCE SHEETS), AND
AUTHORITIES ARE PUZZLED AT RECENT INCREASE OF PREMIUM
SINCE ABOLITION OF SURRENDER REQUIREMENT. WARD
PRIVATELY EXPRESSED DOUBT WHETHER ANYONE COULD SUGGEST
A MEANS OF BRINGING PREMIUM DOWN (E.G., BY PERMITTING
INTEREST AND DIVIDEND YIELDS TO BE SOLD IN INVESTMENT
CURRENCY MARKET) WHICH HAD NOT ALREADY BEEN CONSIDERED
AND REJECTED AS UNWORKABLE.

6. THERE WAS MUCH DISCUSSION ON VIEW EXPRESSED IN
SECRETARIAT'S DRAFT OF IC REPORT THAT UK'S ECONOMIC AND
FINANCIAL SITUATION WARRANTED FUNDAMENTAL LIBERALIZATION
SO AS TO PERMIT NET CAPITAL OUTFLOWS VIA DIRECT AND
PORTFOLIO INVESTMENT BY UK RESIDENTS. WARD CONTENDED
THAT REAL ECONOMY HAS NOT YET SHOWN NECESSARY
IMPROVEMENT AND THAT EXTERNAL FINANCIAL SITUATION
COULD NOT BE CONSIDERED AS FUNDAMENTALLY IMPROVED
UNTIL THE PAYMENTS POSITION HAD SHOWN STABILITY FOR
SEVERAL YEARS. HE CITED DOWNWARD REVISIONS OF
FORECAST 1978 CURRENT ACCOUNT SURPLUS AND SHARP
DROP OF RESERVES. WARD ALSO EMPHASIZED THE NEED TO
REPAY AT LEAST SOME OF THE "DEBT MOUNTAIN" COMING DUE
IN THE EARLY 1980'S. IC AGREED TO TONE DOWN REPORT'S
ASSESSMENT OF POSITION, BUT MAINTAINED CALL FOR
FUNDAMENTAL REVIEW OF LIMITATION ON NET OUTWARD CAPITAL
TRANSACTIONS BY RESIDENTS.
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7. AGAINST BACKGROUND OF WARNING THAT STEPS UK WOULD BE FORCED TO TAKE BY YEAR-END IN RESPONSE TO EC CALLS FOR FURTHER LIBERALIZATION ARE LIKELY TO BE DISCRIMINATORY, IC SPENT CONSIDERABLE TIME DISCUSSING TREATMENT IN REPORT OF EXISTING DISCRIMINATION. IC AGREED (AND UK REPS CONCEDED) THAT THERE IS NO ECONOMIC JUSTIFICATION FOR DISCRIMINATION -- UK REPS FRANKLY ADMITTED THAT THEIR POSITION IN EARLIER NEGOTIATIONS WITH EC WAS TO CONCEDE MINIMUM POSSIBLE LIBERALIZATION, BUT THAT EXTENDING STEPS TAKEN, WHERE DISCRIMINATORY, TO ALL OECD COUNTRIES WOULD NOT BE COSTLY TO UK. IT WOULD, HOWEVER, BE VERY DIFFICULT
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POLITICALLY TO EXTEND LIBERALIZATION IN DIRECT INVESTMENT AREA (WHICH WARD POINTED OUT IS OF LITTLE CONSEQUENCE SINCE "SUPER CRITERION" INVESTMENTS ARE RARE). REPORT WILL BE REDRAFTED TO REFLECT MORE PRECISELY LEGAL BASIS UNDER CMC OF DISCRIMINATORY NATURE OF RECENT LIBERALIZATION, TAKING INTO ACCOUNT DIFFERING VIEWS ON GENERAL QUESTIONS, AS SET FORTH IN REF C (COPY BEING MAILED TO EMBASSY LONDON/AMMERMAN). MORE IMPORTANTLY, DRAFT RECOMMENDATIONS (TO BE ADOPTED BY COUNCIL) WILL SET FORTH OECD HOPE THAT UK DISCRIMINATION, WHILE PROBABLY LEGALLY PERMISSIBLE UNDER CMC, WILL BE ELIMINATED, PARTICULARLY WITH RESPECT TO PERSONAL CAPITAL MOVEMENTS.

8. WARD SAID HMG WOULD HAVE GREAT DIFFICULTY IN RESPONDING POSITIVELY TO RECOMMENDATION THAT UK GRADUALLY PERMIT STERLING ISSUES BY INTERNATIONAL FINANCIAL INSTITUTIONS (IFI'S). IC AGREED TO SOME TONING DOWN OF LANGUAGE (AND EXCLUDING REFERENCE TO BORROWINGS

OF OR GUARANTEED BY MEMBER GOVERNMENTS) BUT WAS NOT IMPRESSED BY UK ARGUMENT THAT IFI'S ARE NOT IN GREAT NEED OF FUNDS AND THAT SUCH ISSUES WOULD BE INCOMPATIBLE WITH PROVISIONS OF BASLE ACCORD THAT INTERNATIONAL ROLE OF STERLING SHOULD BE REDUCED. UK REPS DID NOT RESIST RECOMMENDATION THAT RESERVATIONS ON PERSONAL CAPITAL MOVEMENTS BE LIFTED (COMPLIANCE WOULD AUTOMATICALLY ERASE THE DISCRIMINATION PRESENTLY PRACTICED ON THESE ITEMS, EXCEPT FOR EMIGRANTS' REMITTANCES ABOVE CERTAIN LIMITS WHICH ARE SUBJECTED TO USE OF INVESTMENT CURRENCY). WARD ACKNOWLEDGED THAT UK MIGHT LOGICALLY BE EXPECTED TO RELIBERALIZE FINANCING OF THIRD COUNTRY TRADE SINCE THIS ITEM WAS MOST RECENT CASE OF INTENSIFIED RESTRICTIONS; LIMITED OFFICIAL USE

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HOWEVER, AUTHORITIES WERE SURPRISED BY LARGER THAN EXPECTED ONE-TIME INFLOW WHICH RESULTED FROM 1976 MEASURE AND ARE RELUCTANT TO INCUR OUTFLOW OF THIS MAGNITUDE.

9. FOURTH EXAMINATION OF IRISH RESERVATIONS TO CMC (DAF/INV/78.34). GIVEN DE FACTO, IF NOT DE JURE, CURRENCY UNION BETWEEN IRELAND AND UNITED KINGDOM AND LOGIC OF IRELAND'S ADHERING TO UK EXCHANGE CONTROL SYSTEM, IC REVIEW OF IRISH RESERVATIONS WAS PERFUNCTORY. ONLY CONTROVERSIAL AREA WAS DISPARITY BETWEEN IRISH AND UK DISCRIMINATION IN FAVOR OF EC. (IRELAND HAS NO UPPER LIMITS ON PERSONAL CAPITAL MOVEMENTS TO EC AREA. MORE SIGNIFICANTLY, NO RESTRICTIONS AT ALL, INCLUDING PAYMENT CHANNELS, APPLY TO PURCHASES OF REAL ESTATE IN EC AREA.) WHILE MAINTAINING BASIC RECOMMENDATION THAT DISCRIMINATION BE ENDED, WORDING OF IC REPORT WILL TAKE INTO ACCOUNT FACT THAT IRELAND HAS MOVED FURTHER THAN UK IN MEETING EC REQUIREMENTS FOR LIBERALIZATION AND THUS WOULD HAVE SOMEWHAT MORE DIFFICULTY IN EXTENDING THIS LIBERALIZATION TO OTHER OECD MEMBERS, PARTICULARLY WITH RESPECT TO REAL ESTATE PURCHASES WHERE THE UK DID NOT LIBERALIZE AT ALL. U.S. EXPERT POINTED OUT THAT DIFFERENCE BETWEEN EC AGREEMENTS WITH UK AND IRELAND CREATED A CERTAIN LEGAL PROBLEM. (AGREED INTERPRETATION OF ARTICLE 10 OF CMC PROVIDES THAT LIBERALIZATION UNDERTAKEN VIS-A-VIS EC MEMBERS ONLY BE APPLIED AMONG ALL MEMBERS OF THAT "SPECIAL SYSTEM". IF EC REGS REQUIRE IRELAND TO LIBERALIZE FULLY THESE PERSONAL CAPITAL MOVEMENTS, THEY MUST BE APPLIED EQUALLY TO THE UK IN ORDER FOR IRELAND TO JUSTIFY NOT EXTENDING THEM TO OTHER OECD MEMBERS BY RECOURSE TO ARTICLE 10.)

10. INVOCATION BY JAPAN OF DEROGATION CLAUSE OF CMC.
JAPANESE NOTIFICATION, TIR(78)2, OF BAN
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IMPOSED IN MARCH ON NON-RESIDENTS' PURCHASE OF YEN-
DEMONIATED SECURITIES (WITH 5 YEARS AND NONE MONTH OR

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LESS TO MATURITY) AROUSED LITTLE COMMENT. JAPANESE
EXPERT SAID THAT GOJ CONCERN WITH POSSIBILITY OF
"SERIOUS DISTURBING EFFECTS ON THE FOREIGN EXCHANGE
MARKET" REFERRED TO VOLATILE FLUCTUATIONS RATHER THAN
THE LEVEL OF THE RATE. HE FURTHER EXPLAINED THAT
EXEMPTION FOR SECURITIES ISSUED BY NON-RESIDENTS
SIMPLY REFLECTED DESIRE TO AVOID CONTRADICTION WITH

GOAL OF EXPANDING INTERNATIONAL USE OF YEN. GIVEN
PRECISELY SPECIFIED JUSTIFICATION IN JAPANESE
MEMORANDUM, EMPHASIS ON TEMPORARY NATURE OF CONTROLS
AND IC TRADITION OF NOT QUESTIONING INITIAL REQUEST
FOR DEROGATION (NOT TO MENTION SHARP UPWARD MOVEMENT
OF YEN IN RECENT DAYS), IC HAD NO DIFFICULTY RECOMMEND-
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ING APPROVAL.

11. INVOCATION BY SWITZERLAND OF DEROGATION CLAUSE OF
CMC.

SWISS NOTIFICATION, TIR(78)3, OF ITS FEBRUARY MEASURES
AROUSED SOME COMMENT ALTHOUGH IC ALSO AGREED IN THIS
CASE TO RECOMMEND APPROVAL. GOS MEASURES ARE RATHER
MORE COMPLEX THAN JAPANESE, AND IC WAS NOT OVERLY
IMPRESSED BY ARGUMENT (WHICH IT HAS HEARD BEFORE)
THAT SWISS EXPORTS ARE ENDANGERED BY APPRECIATION OF
FRANC TO "LEVELS...WHICH NO LONGER HAVE ANY RELATION
TO ECONOMIC REALITIES." U.S. EXPERT ALSO TOOK
EXCEPTION TO SOME PASSAGES IN INTRODUCTION OF SWISS
MEMORANDUM--E.G., CHARACTERIZATION OF EXCHANGE MARKET
AS "CHRONICALLY ERRATIC AND UNSTABLE". QUESTION
WAS RAISED WHETHER SWISS MEASURES LIMITING IMPORTS OF
FOREIGN BANKNOTES REQUIRED DEROGATION ALSO TO INVISIBLES
CODE AS WELL AS TO CMC.

12. SPECIAL SESSION ON DIRECT INVESTMENT

THOSE EXPERTS WHO SPOKE GENERALLY ENDORSED SECRETARIAT'S
NOTE DAF/INV/78.35. U.S. ALTERNATE SUPPORTED
SUGGESTION THAT MAXIMUM POSSIBLE INFORMATION BE SUPPLIED
IN ADVANCE BY INDIVIDUAL COUNTRIES AND ALSO AGREED
THAT EXERCISE BE EXPANDED TO INCLUDE OUTWARD DIRECT
INVESTMENT. SHE DREW ATTENTION TO THE RELEVANCE OF
SPECIAL SESSION'S PROPOSED CONSIDERATION OF PER-
FORMANCE REQUIREMENTS FOR INVESTMENT COMMITTEE'S
(CIME) WORK ON NATIONAL TREATMENT AND ON INCENTIVES/
DISINCENTIVES, RECALLING THAT CIME HAS OVERALL
RESPONSIBILITY FOR THESE FIELDS AND THAT IC
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CONSIDERATION OF SOME ASPECTS SHOULD NOT BE SEEN
AS MAKING CIME'S WORK IN SUCH FIELDS SUPERFLUOUS.
IC CONCURRED AND AGREED THAT RESULTS OF SPECIAL

SESSION SHOULD BE CONVEYED TO CIME. IC WILL INVITE CIME CHAIRMAN AND CHAIRMAN OF ITS WORKING PARTY ON NATIONAL TREATMENT TO PARTICIPATE. SESSION SCHEDULED FOR NOVEMBER 27 AND 28 (POSSIBLY FINISHING AT NOON ON SECOND DAY). BIAC WILL BE ASKED TO SUBMIT VIEWS ON SPECIFIC CASES -- A DECISION WHICH CAUSED MOST IC EXPERTS TO FAVOR EXTENDING SIMILAR INVITATION TO TUAC. U.S. EXPERT EXPRESSED DOUBT THAT TUAC COULD MAKE USEFUL CONTRIBUTION TO SPECIAL SESSION, BUT RECOGNIZED DESIRABILITY OF MAINTAINING BALANCE. INVITATIONS WILL BE DRAFTED TO ENSURE THAT BIAC AND TUAC CONTRIBUTIONS ARE NARROWLY CONFINED TO THE SUBJECT MATTER (LEST TUAC PROPOSE A NEW CODE FOR DELIBERALIZATION OF CAPITAL MOVEMENTS).

13. OTHER BUSINESS. CONSIDERATION OF FRENCH REGULATIONS GOVERNING FINANCING OF OUTWARD DIRECT INVESTMENT (DAF/INV/78.36) WAS POSTPONED IN VIEW OF LATE APPEARANCE OF DOCUMENT. NEXT IC MEETING SET FOR OCTOBER 2 - 4. TENTATIVE DATES FOR DECEMBER MEETING ARE 6TH - 8TH. SALZMAN

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